

IN THE

Supreme Court of the United States

October Term, 1946

No.....

GORDON M. MATHER,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

**PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SIXTH CIRCUIT AND BRIEF IN SUPPORT
THEREOF.**

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*To the Honorable Chief Justice and Associate Justices of
the Supreme Court of the United States:*

Your petitioner respectfully shows:

I

SUMMARY STATEMENT OF THE MATTER INVOLVED

This case involves the taxation of trust income for the years 1940 and 1941. The issue is whether certain trusts created by petitioner are revocable—in which case

the income is taxable to petitioner under Section 166 of the Internal Revenue Code—or irrevocable, in which case the income is not taxable to petitioner under Section 166.

1. Facts

There are no disputed facts. The case was submitted to the Tax Court upon a stipulation of facts (R. 27-30). Briefly, these are as follows:

The Trust Agreements

Shortly following the respective births of four of his children petitioner created a trust for each of them. These trusts are identical in their provisions with the exception of the date of execution and the name of the beneficiary. The Toledo Trust Company (successor to The Summit Trust Company, named as Trustee in each agreement) is now the Trustee. The designation of each trust on the Trustee's records, the name and birth date of the beneficiary and the respective dates of execution of the trusts are as follows:

Designation Of Trust	Name of Beneficiary	Date of Birth of Beneficiary	Date of Execution of Trust Indenture
Mather Trust #36	Rathbun F. Mather	Jan. 15, 1920	June 15, 1922
Mather Trust #37	George Mather	July 7, 1921	June 15, 1922
Mather Trust #49	Adele Mather	May 7, 1923	Dec. 31, 1923
Mather Trust #131	Catherine Mather	Nov. 27, 1924	July 1, 1925

A copy of one of the trust agreements is attached to the stipulation (R. 30-40). The beneficiary provisions of the trusts are set forth in Article I, Section 6 of each trust (R. 33-36). The trust is a long-term trust. An individual child is named as the beneficiary of each trust and the principal is distributable to such child at the ages

of thirty, thirty-five and forty (subject to the Trustee's right to withhold the final distribution for a longer period). Should the beneficiary die, the trust property is to be held for the beneficiary's issue, or if none, then it is to be distributed to the Donor's other children or their issue. Income is distributable to the beneficiary after attaining the age of twenty-five, subject to distribution prior thereto for the maintenance and education of the beneficiary "should same become burdensome to Donor." It is a stipulated fact, however, that the maintenance and education of his children has never become burdensome to petitioner (Par. 7 of Stipulation of Facts, R. 28); and it is a further stipulated fact that none of the trust income was distributed during the years 1940 and 1941 here in question (Par. 4 of Stipulation of Facts, R. 28).

The principal question in this case arises in connection with certain rights of petitioner, as grantor, with respect to administrative control over investment of the trust property. Full administrative control of the trust property is vested in the independent corporate Trustee, subject only to petitioner's right, if he so desires, to direct investments. Thus, it is provided in Section 1, Article I of the trust that the Trustee may invest in

"* * * such securities as Trust Companies are now empowered by the laws of the State of Ohio to invest trust funds, or in such securities as the Donor may direct in writing." (R. 31);

while in Section 4, Article V, it is provided that:

"The Trustee is authorized and directed to make all loans, sales, and purchases which Donor may hereafter direct in writing." (R. 39.)

Trust Income and Assessment of Income Tax

On April 25, 1944, the Commissioner sent petitioner a notice of deficiency (R. 8-13) recomputing petitioner's gross income for the years 1940 and 1941 by including therein all of the income of the four trusts and assessing deficiencies for those years in accordance with such recomputation. On July 22, 1944, petitioner filed his petition with the Tax Court requesting a redetermination of such deficiencies and a finding that none of such trust income should be taxable to him as grantor.

At the time of assessing the deficiency the Commissioner claimed that the trust income was taxable to petitioner under Sections 22(a) and 167 of the Internal Revenue Code. (See "Explanation of Adjustments" attached to deficiency notice, R. 10, 12.) Subsequently, in his brief before the Tax Court, the Commissioner added a third section upon which he relied, namely, Section 166.

2. Opinions of the Courts Below

The Tax Court, in its opinion promulgated on October 30, 1945 (R. 15-23), sustained the assessment of the deficiency by the Commissioner. However, in doing so, the Tax Court relied solely on the provisions of Section 166. The Tax Court did not mention Section 22(a) other than to note that the Commissioner had asserted its applicability. As to Section 167, the Tax Court merely expressed a doubt as to whether or not the income was taxable to petitioner under the provisions of that section.

The opinion of the Tax Court is based solely upon its conclusion that the trust income is taxable to the petitioner under the provisions of Section 166. This is apparent from the following statement in its opinion:

"But even if Section 167 is not applicable on the facts, we think that the income of the trusts must be held taxable to petitioner under Section 166 because of petitioner's retention of the right to require the trustee to make loans, sales, and purchases such as he might direct in writing. That provision of the trust agreements is also without any qualification. Petitioner was under no fiduciary obligation to use the rights to the best interests of the beneficiaries. For all that the trust agreements show, and we have no other evidence before us, he could have required the trustee to sell the trust assets or lend the trust funds to himself upon any terms that he might have named. Such rights have been held to be tantamount to a power to revoke the trust. *Estate of William J. Garland*, 42 B. T. A. 324 (supplemented 43 B. T. A. 731); *Percy M. Chandler*, 41 B. T. A. 165, affd. 119 Fed. (2d) 623; *Charles T. Fisher*, 28 B. T. A. 1164." (R. 22.)

Pursuant to its opinion, the decision of the Tax Court was entered December 29, 1945 (R. 25).

On Appeal, the Circuit Court of Appeals for the Sixth Circuit, without opinion, affirmed the decision of the Tax Court "upon the grounds and for the reasons stated in its opinion * * *." The decision of the Court of Appeals was entered October 17, 1946 (R. 51).

3. Statute Involved

The only statute involved is that under which the courts below held the trust income to be taxable to petitioner, namely, Section 166 of the Internal Revenue Code. The section applies only to revocable trusts and provides that the income of such trusts is taxable to the grantor.

"Sec. 166. REVOCABLE TRUSTS.

"Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, then the income of such part of the trust shall be included in computing the net income of the grantor."

II

JURISDICTION

1. The date of the judgment to be reviewed is October 17, 1946 (R. 51).

2. The statutory provision which is believed to sustain the jurisdiction of this court is Judicial Code, Section 240, as amended by the Act of February 13, 1925, C. 229, Sec. 1 (43 Stat. 938, 28 U. S. C. A. Sec. 347).

III

THE QUESTION PRESENTED

The sole basis for the Tax Court's decision was its conclusion that the petitioner's right to direct trust investments, that is, purchases, sales and loans, amounted in substance to a power to revoke and that, consequently, the trust income was taxable to petitioner under Section 166 of the Internal Revenue Code. The Court of Appeals adopted this as the basis for its judgment of affirmance. The single question presented for review, therefore, is this:

Does the retention, by the donor of a trust, of the right to direct the trustee in the making of loans, sales and purchases, constitute a power of revocation of the trust by virtue of which title to the corpus of the trusts may be revested in the donor, so that the income is taxable to the donor under Section 166 of the Internal Revenue Code?

IV

**REASONS RELIED ON FOR THE ALLOWANCE
OF THE WRIT**

1. The Circuit Court of Appeals for the Sixth Circuit has decided a federal question in a way probably in conflict with applicable decisions of this court.

In applying federal tax statutes to trusts wherein the grantor of the trust retained control over trust investments, this court has held that the reservation of such control does not make the trust revocable within the meaning of those sections of the Internal Revenue Code taxing revocable trusts.

Helvering vs. Stuart, 317 U. S. 154;

Reinecke vs. Northern Trust Co., 278 U. S. 339.

The decision holding the trusts here in question to be revocable is apparently in direct conflict with the decisions of this court.

2. The Circuit Court of Appeals for the Sixth Circuit has decided an important question of local law in a way probably in conflict with applicable local decisions.

Insofar as the question of the right to use a power over trust property for personal aggrandizement or benefit is one involving property rights subject to local decisions, it is clear that fundamental equitable principles of trust law, as applied by the courts of Ohio and of every other state, would prevent the use of the power here in question for the purpose of revoking the trust and retaking the trust corpus.

Shank vs. DeWitt, 44 O. S. 237, 6 N. E. 235;

Carrier vs. Carrier, 226 N. Y. 114, 123 N. E. 135.

Wherefore, it is respectfully submitted that this petition for writ of *certiorari* to review the judgment of the Circuit Court of Appeals for the Sixth Circuit should be granted.

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GEORGE F. MEDILL,
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IN THE
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No.....

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COMMISSIONER OF INTERNAL REVENUE,

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**BRIEF IN SUPPORT OF PETITION FOR WRIT OF
CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE SIXTH CIRCUIT.**

I

OPINIONS OF THE COURTS BELOW

The opinion of the Tax Court was promulgated October 30, 1945, and is officially reported at 5 T. C. 1001.

The Circuit Court of Appeals for the Sixth Circuit did not deliver an opinion. Its order of affirmance has not been officially reported.

II

JURISDICTION

The grounds on which the jurisdiction of this court is invoked have been set forth in the foregoing petition.

III

STATEMENT OF THE CASE

The essential facts of the case are fully stated in the foregoing petition and in the interest of brevity are not repeated here.

IV

SPECIFICATION OF ERRORS

The Circuit Court of Appeals erred:

1. In affirming the decision of the Tax Court that the income of trusts wherein petitioner reserved the right to direct investments is taxable to petitioner under the provisions of Section 166 of the Internal Revenue Code on the grounds and for the reason that such reserved right is tantamount to a power to revoke.

V

ARGUMENT**Summary of Argument**

The right to direct investments is not and never has been recognized as a power which may be used directly or indirectly by the holder thereof, including the grantor, for the purpose of personal gain or benefit.

A. As a matter of property rights subject to local law, the grantor of a trust may not use a reserved right to direct investments for the purpose of revoking the trust. A completed gift in trust cannot be revoked unless the power to revoke is expressly reserved. The right to direct investments is nothing more nor less than control over the administration of the trust and is neither an express nor an implied power to change, alter, amend or revoke property rights in the trust corpus.

B. The foregoing principles applicable in local jurisdictions to questions of property rights are likewise applicable and have been applied to the determination of federal tax questions.

Point A

As a Matter of Fundamental Equitable Principles, the Reserved Right to Direct Trust Investments May Not Be Used for the Purpose of Revoking the Trust.

Section 166 of the Internal Revenue Code makes taxable to the grantor the income of any trust wherein he reserves the power to "revoke," that is, take back and retain as his own the property he has given to the trustee. Insofar as applicable to this case, it provides:

"Sec. 166. Revocable Trusts. Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested * * * (1) in the grantor * * * then the income of such part of the trust shall be included in computing the net income of the grantor."

The sole question in this case, therefore, is whether the provision in the trust agreement that

"The trustee is authorized and directed to make all loans, sales, and purchases which donor may hereafter direct in writing"

gives the petitioner the right and power to revoke the trust.

It is fundamental trust law that where the complete trust agreement is set forth in writing, there is no implied power to revoke a trust—in the absence of fraud or mistake, the grantor can revoke only if and to the extent that he has expressly and clearly reserved such right.

40 *Ohio Jurisprudence*, p. 561;

Bogert, *Trusts and Trustees*, Section 993;

Restatement of the Law of Trusts, Section 330.

The question is simply whether or not the right to control the *administration* of the trust—in this case by directing investments—can in any way be regarded as a right to control the *beneficial property interests* under the trusts.

The two rights are entirely unconnected. The right to direct investments is not a right to change, alter or revoke beneficial rights even by remote inference. It would seem clear, therefore, that the grantor would not be permitted to accomplish an indirect revocation when it is apparent that he could not do so directly.

It may be conceded that if the grantor reserves a right to buy or borrow the trust assets for his own benefit and on his own terms he has effectually reserved a right to revoke. But such a right cannot be implied—such a right is never recognized unless clearly set forth in language that cannot be misunderstood. Administrative control cannot be turned into a right to retake or recapture trust property unless the right is expressly reserved. In other words, if we regard the grantor as the holder of a power over trust property it is clear he cannot exercise the power for his own benefit unless specifically authorized to do so by the terms of the trust. As stated by the Supreme Court of Ohio in *Shank vs. DeWitt*, 44 O. S. 237, 6 N. E. 235:

“‘A power cannot be executed in favor of the donee of the power unless the instrument specially authorizes him to do so. The donee of a power cannot execute it for any pecuniary gain, directly or indirectly, to himself.’ 2 Perry on Trusts, Section 511.”

The equitable principle governing the use of a reserved power to direct investments was set forth by Judge Cardozo while a member of the New York Court of Appeals. In the case of *Carrier vs. Carrier*, 226 N. Y. 114, 123 N. E. 135, the grantor retained the “absolute and uncontrolled” right to direct investments. After threats by the grantor to loan the funds to himself and otherwise take advantage of his power, the lower court issued an injunction placing restrictions upon the exercise of the grantor’s power and in upholding this action Cardozo said:

"It is true that the creator of this trust had reserved to himself the broadest rights of management. His discretion was to be 'absolute and uncontrolled.' That does not mean, however, that it might be recklessly or willfully abused. He had made himself a trustee, and in so doing he had subjected himself to those obligations of fidelity and diligence that attach to the office of trustee. He had power to 'invest' the moneys committed to his care. He had no power, under cover of an investment, to loan them to himself. His discretion, however broad, did not relieve him from obedience to the great principles of equity which are the life of every trust."

Point B

The Principles Are Applicable in Determining Federal Tax Questions

The foregoing equitable principles which have been applied to the settlement of rights and interests among the parties themselves have also been applied by this court in determining questions of taxation.

This court has held directly that the retention of administrative powers, including complete control over investments, does not constitute a power of revocation. In *Reinecke vs Northern Trust Co.*, 278 U. S. 339, the grantor "reserved to himself power to supervise the reinvestment of trust funds, to require the trustee to execute proxies to his nominee, to vote any shares of stock held by the trustee, to control all leases executed by the trustee, and to appoint successor trustees." The question was whether or not the trust corpus was subject to estate tax as a part of the grantor's estate on the ground that the reserved powers made the trust revocable. This court, in holding that these reserved powers of management did not make the trust revocable, said, at page 346:

"Nor did the reserved powers of management of the trusts save to decedent any control over the economic benefits or the enjoyment of the property. He would equally have reserved all these powers and others had he made himself the trustee, but the transfer would not for that reason have been incomplete. The shifting of the economic interest in the trust property which was the subject of the tax was thus complete as soon as the trust was made. His power to recall the property and of control over it for his own benefit then ceased. * * *"

The case of *Helvering vs. Stuart*, 317 U. S. 154, directly involved the question of the taxation of trust income to the donor of a trust containing reserved powers of management. The trust provided that:

"Eighth. The Donor reserves and shall have the right at any time and from time to time to direct the Trustees to sell the whole of the Trust Fund, or any part thereof, and to reinvest the proceeds in such other property as the Donor shall direct. * * *"

Notwithstanding this reserved power, the income of the trust was held not taxable to the donor under Section 166.

The error into which the Tax Court fell is immediately apparent from an examination of the three cases* cited and relied on in its opinion. In all three cases the grantor had expressly reserved the right to use his powers for his own benefit. For example, in the *Chandler case* the agreement expressly provided that the trustee,

"shall make such sale * * * either to Grantor or to a third party * * * of all or any part of the Trust Fund and for such considerations and upon such terms as to credit or otherwise as Grantor may direct."

* *Chandler vs. Commissioner*, 41 B. T. A. 765, affirmed, 119 F. (2d) 623 (C. C. A. 3rd, 1941); *Estate of William J. Garland*, 42 B. T. A. 324; *Charles T. Fisher*, 28 B. T. A. 1164.

The Court of Appeals in that case was particular to point out the difference between a trust in which the grantor has reserved a power with the expressed right to use it for his own benefit and one in which there is no such expressed right.

The Tax Court apparently proceeded on the theory that, unless *expressly prohibited*, the grantor may use his administrative control for his own benefit. The law, however, is the exact reverse—it is that, unless *expressly stated*, the grantor cannot use such power for his own benefit. In other words, silence is tantamount to a prohibition against using the power for personal gain or benefit.

With respect to the question of taxation of the trusts under Sections 22(a) and 167, that question was fully argued in the courts below and neither the Tax Court nor the Court of Appeals relied on those sections in determining that the income was taxable to petitioner. We may assume, therefore, that the courts below felt that the trust income was not taxable to petitioner under either of those sections. We merely point out, in passing, that under either of those sections, income is taxable to the grantor of a trust on an altogether different basis than under Section 166.

VI

CONCLUSION

We believe the foregoing illustrates that the Tax Court and Circuit Court of Appeals have rendered a judgment which is patently contrary to the trust law as applied by the Ohio courts; and which further is directly contrary to the decisions of this court.

It is, therefore, respectfully submitted that this case is one calling for the exercise by this court of its supervisory powers, in order that the errors herein pointed out may be corrected; that the law may be properly and authoritatively defined; and that the judgment of the Tax Court and of the United States Circuit Court of Appeals for the Sixth Circuit may be reversed in order that justice may be done to petitioner; and that to such end a writ of *certiorari* should be granted and this court should review the decision of the United States Circuit Court of Appeals for the Sixth Circuit and finally reverse it.

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